

1-2007

The Fallen Angel

Roger Bernhardt

Golden Gate University School of Law, rbernhardt@ggu.edu

Follow this and additional works at: <http://digitalcommons.law.ggu.edu/pubs>

 Part of the [Property Law and Real Estate Commons](#)

Recommended Citation

Bernhardt, Roger, "The Fallen Angel" (2007). *Publications*. Paper 388.
<http://digitalcommons.law.ggu.edu/pubs/388>

This Article is brought to you for free and open access by the Faculty Scholarship at GGU Law Digital Commons. It has been accepted for inclusion in Publications by an authorized administrator of GGU Law Digital Commons. For more information, please contact jfischer@ggu.edu.

January 2007

The Fallen Angel

Roger Bernhardt

Hildegarde Merrill, the defendant broker in *Warren v Merrill* (2006) 143 CA4th 96, 49 CR3d 122, reported at p 28, got herself into big trouble for trying to cut too many corners in putting her client (John Warren) into a condominium unit that he really couldn't afford. From the way the court described her actions, Hildegarde defrauded John by falsely promising him that title to the unit would eventually go to him (and by concealing from him a \$6000 price reduction she had received from the seller that should have gone to him); she defrauded the seller, probably, by concealing the fact that she was using her commission to enable the buyer to make the downpayment and putting title in the name of a relative; and she was defrauding the lender by having that relative—her daughter, Charmaine, the nominal purchaser—falsely represent on her loan application that she intended to live in the unit (and probably also misrepresenting her income).

Hildegarde's problem—one common to many brokers—was that her client did not have the wherewithal to purchase the property he wanted to buy: He lacked both sufficient cash for a downpayment and sufficient credit to obtain the necessary loan for the balance. The downpayment issue was easy. The creditworthiness issue was harder; this was where Hildegarde went wrong.

The downpayment shortfall was met by Hildegarde's adding \$27,000 of the commission she received from the seller to John's own \$50,000, thereby coming up with the required \$77,000 (and with John repaying that \$27,000 debt over the next several months). She should have informed the seller of her involvement in the purchase, but since he got the price he wanted and was not extending credit, it probably mattered little to him.

Hildegarde's strategy for the borrowing shortage was to substitute in her daughter as the nominal purchaser, because she allegedly had better credit (although that hardly seems to have been the case). John's name, which had initially appeared on the sales contract, was removed. The loan application came only from Charmaine and, on closing, Charmaine alone took title. John's role was to provide \$50,000 of the downpayment, take possession of the unit, and make all of the necessary payments on it, which he did until he defaulted a few months later and was evicted by Hildegarde, acting as Charmaine's agent. This suit by John, seeking damages and a constructive trust, followed. It was successful because Hildegarde was found to have breached her fiduciary duties and committed fraud upon John.

The fraud that Hildegarde was held to have committed was promising John that title would be transferred to him after escrow closed and he had paid Charmaine a \$10,000 fee for having been his angel—when, in fact, Hildegarde never intended for that to happen. (The court mentioned in passing other fraudulent acts by Hildegarde; apparently, they did not count for much.)

A promise to transfer title made without any intent to perform clearly constitutes fraud, thus there was nothing remarkable in the final outcome of the case on that score. Even if Hildegarde had not been John's broker (she was a dual agent in the sale and also his agent initially in finding

a mortgage), she would have been held liable as long as John's testimony about her false promise was believed, with or without her fiduciary breaches. More interesting to me is whether Hildegard could have carried out her scheme without having to defraud everybody along the way.

It's easy to eliminate the more outrageous features of the arrangement: The seller would have been informed that his broker was assisting the buyer in making the downpayment; the price credit would have been used on the buyer's behalf; and the broker would intend that the buyer really get title at the end. That leaves only the credit aspects to confront.

Real estate brokers frequently encounter situations where a purchaser lacks sufficient creditworthiness to obtain the loan needed to finance acquisition of the property. An obvious solution is to include in the deal others with better credit. Relatives are an obvious example: If John's parents were to come to his aid (his grandfather, after all, was Earl Warren), that could readily solve the loan problem. Indeed, wealthy relatives can also solve the downpayment problem, as parents so often do when their children are buying their first house. Mom makes the downpayment, goes on title with the kids, and signs for the loan, until it is safe to turn everything over to the youngsters.

The absence of a qualified family member or close friend makes such an arrangement harder, but not impossible. It is only money we are talking about, so even a stranger may be available for the right price. In this case, Charmaine (a relative to Hildegard, but not to John) was to be paid \$10,000 for the use of her ostensibly good name as a kind of credit enhancement.

But there are two snags to this idea that one should be careful about; Hildegard ignored both. First, one should not commit "lender fraud" in getting the loan (an accusation that was made several times in the opinion). Not only were Charmaine's income numbers dubious, it was an outright lie that she would be occupying the unit, since she fully intended to remain in Colorado. Charmaine made that misstatement because she could get a better loan by saying so: Interest rates, as well as required downpayments, are lower for borrowers who reside in the properties they are purchasing. But to falsely check off the personal occupancy box in the loan application is to commit fraud, and the lender may someday find out. (The lender seemed indifferent in this case, since John kept sending his mortgage payments directly to it; but even if those payment checks had been more carefully daisy-chained, insurance policies and other papers could tip off a more alert or suspicious creditor.) On discovery, the loan could be called, deficiency protections could be stripped away, civil damages and penal sanctions could be sought from all collaborators, and the broker's license would be in jeopardy if the Real Estate Commissioner ever found out. (It is no wonder that the trial judge cautioned Hildegard to consider pleading the Fifth Amendment rather than continuing to testify.) The higher rate an investor must pay for being truthful in this respect may be a small price to pay, especially since a refinancing in the near future—when the real purchaser has built up his own credit and can take title himself as an occupant—can then help improve that rate.

The second snag is that the arrangement between borrower and angel should be fully documented and carefully drafted. A standard form will rarely work. A lease-option will suffice only in those situations where the angel has invested all of the cash and the credit necessary to complete the purchase, so that the "real" buyer has no legal or equitable ownership and can safely be pushed out of the deal if he defaults on his rent. Even then, if the lease payments are above market rent, I can readily imagine a court finding that the excess parts of the rent

payments were intended to give the tenant some kind of equity build-up or other protection against simple unlawful detainer and termination of his option. (That is certainly what a bankruptcy trustee would claim.)

The paperwork is far more complicated in those situations where, as here, the real purchaser himself is making the downpayment. When John put up \$77,000, but Charmaine took title and leased the property to him, she was acting as owner, optionor, landlady, and constructive trustee—not a simple transaction to structure.

It would be even more complicated if Charmaine had also invested some of her own funds into the property (as, in fact, was the case until John repaid Hildegard's \$27,000 that he had used for the downpayment). If those had been Charmaine's funds, then even if she were a constructive trustee, she would not be compelled to turn title over to John unless she were reimbursed for her contribution. In that case, in addition to fitting all of those labels I already mentioned (owner, optionor, landlord, and trustee), she would also be a lender who should be entitled to hold onto the title she has as security until her loan is repaid—*i.e.*, she should be treated as a mortgagee on top of everything else. It would not be easy to draft all of the documents that the parties should have employed in that kind of transaction.

Indeed, given all of the drafting problems I have named, it seems to me that—apart from having to sleep in his car for awhile until the matter was resolved—John may have made out as well as any attorney could have done for him.

Warren v Merrill (2006) 143 CA4th 96, 49 CR3d 122

Warren, the buyer of a condominium, sued Merrill, his real estate agent, seeking to quiet title and other relief. Merrill had promised Warren, who supplied the downpayment, his name would be placed on the title once the loan, in Merrill's daughter's name, funded and escrow closed. (Warren had a poor credit history and would not have qualified for a conventional loan.) Merrill, whose undisclosed intent was to keep the condominium as an investment, did not honor her promise.

The trial court found Merrill had acquired the condominium through fraud, made material misrepresentations, and breached her fiduciary duties to Warren. The court quieted title and imposed a constructive trust on the property in favor of Warren, and awarded Warren noneconomic as well as punitive damages.

The court of appeal affirmed. Substantial evidence satisfied the elements of constructive and actual fraud. Constructive fraud arises on a breach of duty by one in a fiduciary relationship who misleads another to his prejudice. Actual fraud occurs when a person makes a promise without the intention of performing it; it requires evidence of

- Representation;
- Falsity;
- Knowledge of falsity;
- Intent to deceive; and
- Reliance and resulting damage.

Merrill breached her fiduciary duties toward Warren and committed fraud by deliberately and falsely promising him she would place his name on title to the condominium if he went along with her plan to structure the transaction. Merrill never intended to perform her promise; instead, she intended to procure the condominium for herself but did not disclose her role as a principal in the transaction. Merrill kept the condominium, retaining Warren's downpayment.

It was preposterous to argue that Merrill owed Warren no fiduciary duty because he withdrew from escrow. Instead, Warren was coerced into signing an amendment and into withdrawing from escrow based on Merrill's representations the loan would not fund and the deal would fall apart unless Warren signed the amendment taking his name off title. If Warren withdrew from escrow, his downpayment should have been returned; it was not.

A constructive trust may be imposed when a party has acquired property to which he or she is not justly entitled, if it was obtained by actual fraud or by constructive fraud through the violation of a fiduciary relationship. Such a trust arises by operation of law, and the statute of frauds is no bar.

The fraud perpetrated was Merrill's oral promise to convey without the intent to perform the promise in order to induce Warren to part with his money. A constructive trust arose by operation of law, and the statute of frauds presented no bar. Moreover, given the fraud, equitable estoppel would preclude Merrill from relying on a statute of frauds defense if it were applicable. In addition, Warren's part performance of the oral contract by paying the downpayment would satisfy the statute of frauds.

Generally, an action to quiet title cannot be maintained by the owner of equitable title as against the holder of legal title. However, because of the fraud, Merrill through her daughter acquired only bare legal title, which she held as a constructive trustee for Warren. Based on the equities, Warren held superior title. When legal title has been acquired through fraud, quieting title and making the legal title holder the constructive trustee of the property for the benefit of the defrauded equitable title holder are appropriate remedies.